

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.

Effective evaluation may be to:

- consider short run versus long run consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

2. (a) Define the following terms indicated in bold in the text:

(i) **unemployment rate (paragraph ②)** [2 marks]

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that the unemployment rate is the percentage of people that are unemployed.	1
2	<i>Precise definition</i> An explanation that unemployment rate is the percentage of people that are unemployed, expressed as a percentage of the labour force or workforce.	2

(ii) **business/trade cycle (paragraph ③).** [2 marks]

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that the business/trade cycle shows the increases and decreases in national income (or the level of economic activity or GDP)	1

2 *Precise definition* 2

Different approaches are likely here.

A definition should note two of the following:

- the periodic or regular fluctuations in national income or economic activity or GDP.
- around the productive potential (or long term trend of the economy)
- Economies tend to move through stages including “boom” and “bust”, or other terminology noting the same.

A properly labelled diagram showing a business cycle could earn the full two marks

(b) **Using an appropriate diagram, explain how a government may attempt to close a deflationary gap.** *[4 marks]*

level

0 *Inappropriate answer* 0

1 *Identification of theory* 1-2

To draw an appropriate diagram illustrating a deflationary gap **or** an explanation of how a government may close a deflationary gap.

2 *Correct application of appropriate theory* 3-4

There are several possible approaches here, all of which are equally valid.

- a diagram with a vertical LRAS showing a short run equilibrium output at a level that is less than full employment illustrating a deflationary gap. In this case, the government could fill the gap using supply side policies
- a diagram with a Keynesian LRAS showing a short run equilibrium output at a level that is less than full employment illustrating a deflationary gap. The government could fill this gap by using expansionary fiscal and/or monetary policy
- a Keynesian 45 degree diagram illustrating a deflationary gap. The government could fill this gap by using expansionary fiscal and/or monetary policy

- (c) Explain why deflation (a downward movement in the average level of prices) creates conditions that make it “unfavourable” for business to invest (*paragraph 4*). [4 marks]

level

- | | | |
|---|---|-----|
| 0 | Inappropriate answer | 0 |
| 1 | Identification of appropriate theory
A vague explanation linking deflation to investment | 1-2 |
| 2 | Correct application of appropriate theory
A correct explanation discussing any of the following points would be sufficient for full marks: <ul style="list-style-type: none"> • falling consumer demand reduces the need for investment • investment decisions may be largely affected by expectations and confidence and deflation may reduce consumer and business confidence. There is no reason to increase capacity if expectations are poor • deflation creates uncertainty which deters investment • accelerator effect | 3-4 |

- (d) Using information from the text and your knowledge of economics, evaluate the extent to which unemployment would still be a problem if inflation were allowed to increase. [8 marks]

Answers **may** include:

- An identification of the natural rate of unemployment
- distinction between SR and LR conditions
- use of AD/AS analysis (with diagram) showing that as an economy approaches LRAS inflation rises and unemployment may remain at the natural rate
- use of Phillips curve analysis (with diagram) distinguishing between SR and LR conditions
- use of the data in the article to support the existence of the SRPC relationship
- there may be an observation that supply side policies would be effective at solving both problems

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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